



1. Edward (Ted) Ellyard - Chairman
2. Kenneth Russell - Managing Director
3. Dennis Wilkins - Finance Director
4. Richard O'Shannassy - Non Executive Director
5. John Ribbons - Company Secretary

## DIRECTORS' REPORT

Your directors submit their report on the consolidated entity (referred to hereafter as the Group) consisting of Key Petroleum Limited and the entities it controlled at the end of, or during, the year ended 30 June 2009.

### DIRECTORS

The names and details of the Company's directors in office during the year and until the date of this report are as follows. Where applicable, all current and former directorships held in listed public companies over the last three years have been detailed below. Directors were in office for this entire period unless otherwise stated.

#### Names, qualifications, experience and special responsibilities

**Edward (Ted) Ellyard**, B.Sc.(Geology), Grad.Dip, MAusIMM, MAAPG (Chairman, member of the Audit and Remuneration Committees)

Mr Ellyard is a geologist with over 32 years experience in petroleum and petroleum exploration, development and production. Mr Ellyard graduated from Curtin University, Perth in 1974 and has worked for several major Australian and international resource companies. More recently, Mr Ellyard was Managing Director and CEO of Hardman Resources Ltd from 1996 to late 2004. In that role he oversaw the international expansion of Hardman into the Mauritanian oil/gas discoveries and its dramatic market capitalisation growth from less than \$5 million to over \$1.5 billion. Mr Ellyard has been involved at board level in the management of listed Australian resource companies for the past 20 years and has been a founding director of several companies. Currently, Mr Ellyard is also a director of Minemakers Limited and New World Energy Ltd. Mr Ellyard has not held any former directorships in the last 3 years.

#### Kenneth Russell (Managing Director/CEO)

Mr Russell is a petroleum engineering and production technology specialist with over 35 years experience in the international oil and gas industry. He began his career in the oil producing offshore fields of West Africa with Gulf Oil Limited in Angola and later worked for Flopetrol Schlumberger Limited, involved in well testing, wireline services and production in Australia, Asia and various parts of Africa and Europe.

In 1984 he established a petroleum engineering and production technology consultancy business which participated in the development of many of Australia's oil and gas fields. As well as fields in South East Asia, Brazil, and Russia. His client list included Royal Dutch Shell plc (Shell), Enterprise Oil plc, Chevron Limited, BHP Billiton Limited and Hardman Resources Limited.

Mr Russell has held a number of managerial roles and directorships in the oil and gas industry throughout his career and was a founding Director of Bounty Oil and Gas NL. He has considerable experience, developed over the last 20 years, in international business and has practical operating experience operating in the areas of Key Petroleum's exploration permits. Mr Russell has not held any former directorships in the last 3 years

**Dennis Wilkins**, B.Bus, AICD, ACIS (Finance Director, member of the Audit and Remuneration Committees)

Mr Wilkins is an accountant who has been a director, company secretary or acted in a corporate advisory capacity to listed resource companies for over 20 years. Mr Wilkins previously served as the Finance Director and Company Secretary for a mid-tier gold producer and spent 5 years working for a leading merchant bank in the United Kingdom. Resource postings to Indonesia, South Africa and New Zealand in managerial roles broadened his international experience. Mr Wilkins has extensive experience in capital raising, specifically for the resources industry and is the principal of DWCorporate Pty Ltd which provides advisory, funding and administrative management services to the resource sector. Mr Wilkins is a director of Minemakers Limited. Mr Wilkins is a former director of Marengo Mining Limited and South Boulder Mines Limited within the last 3 years.

**Richard O'Shannassy**, B.Juris.; LL.B. (Hons) (Non Executive Director, Chairman of the Audit and Remuneration Committees)

Mr O'Shannassy is a commercial lawyer with over 27 years experience in the mining and energy sectors. He conducted his own practice in Perth for over 13 years and has also held in-house legal roles.

Most recently he was General Counsel & Company Secretary for Hardman Resources Limited. He has served on mining industry committees over a number of years and is a member of Australian Mining & Petroleum Law Association Inc. Currently Mr O'Shannassy is a director of Minemakers Limited and Hardman Resources Pty Ltd (formerly ASX listed company Hardman Resources Limited). Mr O'Shannassy has not held any former directorships in the last 3 years.

**Terence Nilsen** was a director from the beginning of the financial year until 8 July 2008.

### COMPANY SECRETARY

**John Ribbons**, B.Bus., CPA, ACIS

Mr Ribbons is an accountant who has worked within the resources industry for over 17 years in the capacity of company accountant, group financial controller or company secretary. Mr Ribbons has extensive knowledge and experience with ASX listed production and exploration companies. He has considerable site-based experience with operating mines and has also been involved with the listing of several exploration companies on ASX. Mr Ribbons has experience in capital raising, ASX compliance and regulatory requirements.

## DIRECTORS' REPORT (CONT'D)

Interests in the shares and options of the Company and related bodies corporate

As at the date of this report, the interests of the directors in the shares and options of Key Petroleum Limited were:

|                     | Ordinary Shares | Options over Ordinary Shares |
|---------------------|-----------------|------------------------------|
| Edward Ellyard      | 6,675,000       | 1,000,000                    |
| Kenneth Russell     | 5,815,000       | 2,000,000                    |
| Dennis Wilkins      | 1,000,000       | 750,000                      |
| Richard O'Shannassy | 300,000         | 750,000                      |

### PRINCIPAL ACTIVITIES

The principal activities of the Company during the year were the acquisition of petroleum permits, and the exploration of these permits with the objective of identifying economic oil and gas deposits.

### DIVIDENDS

No dividends were paid or declared during the year. No recommendation for payment of dividends has been made.

### OPERATING AND FINANCIAL REVIEW

#### Finance Review

The Group has recorded an operating loss after income tax for the year ended 30 June 2009 of \$3,136,955 (2008: \$5,745,181).

At 30 June 2009 funds available totalled \$5,594,855.

#### Operating Results for the Year

Summarised operating results are as follows:

|  | 2009           |               |
|--|----------------|---------------|
|  | Revenues<br>\$ | Results<br>\$ |
| Geographic segments  |                |               |
| Australia  | 500,857        | (787,123)     |
| Tanzania   | -              | (2,224,866)   |
| Italy  | 511            | (124,966)     |
| Consolidated entity revenues and loss from ordinary activities before income tax expense | 501,368        | (3,136,955)   |
| Shareholder Returns  |                |               |
|  | 2009           | 2008          |
| Basic loss per share (cents)   | (3.6)          | (6.7)         |

### RISK MANAGEMENT

The board is responsible for ensuring that risks, and also opportunities, are identified on a timely basis and that activities are aligned with the risks and opportunities identified by the board.

The Company believes that it is crucial for all board members to be a part of this process, and as such the board has not established a separate risk management committee.

The board has a number of mechanisms in place to ensure that management's objectives and activities are aligned with the risks identified by the board. These include the following:

- Board approval of a strategic plan, which encompasses strategy statements designed to meet stakeholders needs and manage business risk.
- Implementation of board approved operating plans and budgets and board monitoring of progress against these budgets.

### SIGNIFICANT CHANGES IN THE STATE OF AFFAIRS

Other than as disclosed in this Annual Report, no significant changes in the state of affairs of the Group occurred during the financial year.

### SIGNIFICANT EVENTS AFTER THE BALANCE DATE

No matters or circumstances, besides those disclosed at note 28, have arisen since the end of the financial year which significantly affected or may significantly affect the operations of the Company, the results of those operations, or the state of affairs of the Company in future financial years.

### LIKELY DEVELOPMENTS AND EXPECTED RESULTS

The Group expects to become a producer once the Company completes the acquisition of Midmar Energy Onshore Limited.

### ENVIRONMENTAL REGULATION AND PERFORMANCE

The Company is subject to significant environmental regulation in respect of its exploration activities.

The Company aims to ensure the appropriate standard of environmental care is achieved, and in doing so, that it is aware of and is in compliance with all environmental legislation. The directors of the Company are not aware of any breach of environmental legislation for the year under review.

The directors have considered the recently enacted National Greenhouse and Energy Reporting Act 2007 (the NGER Act) which introduces a single national reporting framework for the reporting and dissemination of information about greenhouse gas emissions, greenhouse gas projects, and energy use and production of corporations. At the current stage of development, the directors have determined that the NGER Act will have no effect on the Group for the current, nor subsequent, financial year. The directors will reassess this position as and when the need arises.

## REMUNERATION REPORT

The remuneration report is set out under the following main headings:

- A Principles used to determine the nature and amount of remuneration
- B Details of remuneration
- C Service agreements
- D Share-based compensation
- E Additional information

The information provided in this remuneration report has been audited as required by section 308(3C) of the Corporations Act 2001.

- A Principles used to determine the nature and amount of remuneration

### Remuneration Policy

The remuneration policy of Key Petroleum Limited has been designed to align director and executive objectives with shareholder and business objectives by providing a fixed remuneration component and offering specific long term incentives based on key performance areas affecting the Company's financial results. The board of Key Petroleum Limited believes the remuneration policy to be appropriate and effective in its ability to attract and retain the best executives and directors to run and manage the Company.

The board's policy for determining the nature and amount of remuneration for board members and senior executives of the Company is as follows:

The remuneration policy, setting the terms and conditions for the executive directors and other senior executives, was developed by the board. All executives receive a base salary or an agreed fee (which is based on factors such as length of service and experience) and superannuation or GST. The board reviews executive packages annually by reference to the Company's performance, executive performance and comparable information from industry sectors and other listed companies in similar industries.

The board may exercise discretion in relation to approving incentives, bonuses and options. The policy is designed to attract and retain the highest calibre of executives and reward them for performance that results in long term growth in shareholder wealth.

Executives are also eligible to participate in the employee share and option arrangements.

The executives receive a superannuation guarantee contribution required by the government, which is currently 9%, and do not receive any other retirement benefits.

All remuneration paid to directors and executives is valued at the cost to the company. Based on each individual's timesheet, costs are allocated to exploration projects and treated in accordance with the accounting policy described at note 1(o), or expensed where the time is not allocated directly to a project. Options are valued using the Black Scholes methodology.

The board policy is to remunerate non executive directors at market rates for comparable companies for time, commitment and responsibilities. The board determines payments to the non executive directors and reviews their remuneration annually, based on market practice, duties and accountability. Independent external advice is sought when required. The maximum aggregate amount of fees that can be paid to non executive directors is subject to approval by shareholders at the Annual General Meeting (currently \$300,000). Fees for non executive directors are not linked to the performance of the Company. However, to align directors' interests with shareholder interests, the directors are encouraged to hold shares in the Company and are eligible to participate in the employee option plan.

### Performance based remuneration

The Company currently has no specific performance based remuneration component built into director and executive remuneration packages.

### Company performance, shareholder wealth and directors' and executives' remuneration

The remuneration policy has been tailored to increase the direct positive relationship between shareholders' investment objectives and directors' and executives' performance. The Company plans to facilitate this process by directors and executives participating in future option issues to encourage the alignment of personal and shareholder interests. The company believes this policy will be effective in increasing shareholder wealth. For details of directors' and executives' interests in options at year end, refer to note 19 of the financial statements.

### B Details of remuneration

Details of the remuneration of the directors, the key management personnel of the Group (as defined in AASB 124 Related Party Disclosures) and specified executives of Key Petroleum Limited and the Key Petroleum Group are set out in the following table.

The key management personnel of Key Petroleum Limited include the directors and company secretary as per page 19 above.

Given the size and nature of operations of Key Petroleum Limited, there are no other employees who are required to have their remuneration disclosed in accordance with the Corporations Act 2001.

## DIRECTORS' REPORT (CONT'D)

## Key management personnel and other executives of Key Petroleum Limited

|  | Short-Term          |                    | Post Employment      | Share-based Payments          |               | Total   |
|--|---------------------|--------------------|----------------------|-------------------------------|---------------|---------|
|  | Salary & Fees<br>\$ | Non Monetary<br>\$ | Superannuation<br>\$ | Termination<br>benefits<br>\$ | Options<br>\$ | \$      |
| <b>Directors</b>                                   |                     |                    |                      |                               |               |         |
| Edward Ellyard                                     |                     |                    |                      |                               |               |         |
| 2009   | 43,680              | 8,850              | 3,931                | -                             | 7,500         | 63,961  |
| 2008   | 51,800              | 6,181              | 4,662                | -                             | -             | 62,643  |
| Kenneth Russell                                    |                     |                    |                      |                               |               |         |
| 2009   | 284,002             | 8,850              | -                    | -                             | 15,000        | 307,852 |
| 2008   | 264,002             | 6,181              | -                    | -                             | -             | 270,183 |
| Dennis Wilkins                                     |                     |                    |                      |                               |               |         |
| 2009   | 146,049             | 8,850              | -                    | -                             | 5,625         | 9,3975  |
| 2008   | 209,017             | 6,181              | -                    | -                             | -             | 215,198 |
| Richard O'Shannassy                                |                     |                    |                      |                               |               |         |
| 2009   | 79,500              | 8,850              | 3462                 | -                             | -             | 41,932  |
| 2008   | 83,928              | 6,181              | -                    | -                             | -             | 90,109  |
| Terence Nilsen (resigned 8 July 2008)              |                     |                    |                      |                               |               |         |
| 2009   | 38,470              | -                  | 3,462                | -                             | -             | 41,932  |
| 2008   | 193,064             | 6,181              | 17,376               | -                             | -             | 216,621 |
| <b>Other key management personnel</b>              |                     |                    |                      |                               |               |         |
| John Ribbons                                       |                     |                    |                      |                               |               |         |
| 2009   | -                   | -                  | -                    | -                             | 3,750         | 3,750   |
| 2008   | -                   | -                  | -                    | +                             | 2,770         | 2,770   |
| <b>Total key management personnel compensation</b> |                     |                    |                      |                               |               |         |
| 2009   | 591,701             | 35,400             | 7,393                | -                             | 37,500        | 671,994 |
| 2008   | 801,811             | 30,905             | 22,038               | -                             | 2,770         | 857,524 |

## C Service agreements

The details of service agreements of the key management personnel of Key Petroleum Limited are as follows:

**Kenneth Russell, Managing Director:**

- Term of agreement – 3 years commencing 24 April 2007.
- Annual consultancy fees of \$290,000 (plus GST) are paid to Russell Group Pty Ltd, a company of which Mr Russell is a director and shareholder.
- The agreement may be terminated by either party by giving 3 months written notice.

**Dennis Wilkins, Finance Director:**

- Term of agreement – four months written notice of termination by either party.
- Mr Wilkins' firm, DWCorporate Pty Ltd, is engaged to provide book keeping, accounting and company secretarial services. Fees are charged on an hourly basis, and all amounts are included in Mr Wilkins' remuneration.

**Richard O'Shannassy, Non Executive Director:**

- Mr O'Shannassy's firm, Richard O'Shannassy & Co Pty Ltd, is engaged to provide legal services. Fees are charged on an hourly basis with a minimum monthly retainer of \$4,000, and all amounts are included in Mr O'Shannassy's remuneration. The agreement has no fixed term, however, requires one month notification of termination.

**D Share-based compensation**

Options are issued to directors and executives as part of their remuneration. The options are not issued based on performance criteria, but are issued to the majority of directors and executives of Key Petroleum Limited to increase goal congruence between executives, directors and shareholders. The following options were granted to or vesting with key management personnel during the year:

|                                       | Grant Date | Granted Number | Vesting Date | Vesting Date | Exercise Price (cents) | Value per option at grant date (cents) | Exercised Number | % of Remuneration |
|---------------------------------------|------------|----------------|--------------|--------------|------------------------|--|------------------|-------------------|
| <b>Directors</b>                      |            |                |              |              |                        |  |                  |                   |
| Ted Ellyard                           | 26/11/2008 | 1,000,000      | 26/11/2008   | 30/11/2010   | 50                     | 0.75                                   | N/A              | 11.7              |
| Ken Russell                           | 26/11/2008 | 2,000,000      | 26/11/2008   | 30/11/2010   | 50                     | 0.75                                   | N/A              | 4.9               |
| Dennis Wilkins                        | 26/11/2008 | 750,000        | 26/11/2008   | 30/11/2010   | 50                     | 0.75                                   | N/A              | 3.5               |
| Richard O'Shannassy                   | 26/11/2008 | 750,000        | 26/11/2008   | 30/11/2010   | 50                     | 0.75                                   | N/A              | 6.0               |
| <b>Other Key Management Personnel</b> |            |                |              |              |                        |  |                  |                   |
| John Ribbons                          | 26/11/2008 | 500,000        | 26/11/2008   | 30/11/2010   | 50                     | 0.75                                   | N/A              | 100.0             |

There were no ordinary shares issued upon exercise of remuneration options to directors or other key management personnel of Key Petroleum Limited during the year. Refer to note 31 for model inputs for the options granted.

**E Additional information****Performance income as a proportion of total compensation**

No performance based bonuses have been paid to key management personnel during the financial year.

**DIRECTORS' MEETINGS**

During the year the Company held twelve meetings of directors. The attendance of directors at meetings of the board were:

|                     | Directors Meetings |    | Meetings of Committees |   |              |   |
|---------------------|--------------------|----|------------------------|---|--------------|---|
|                     |                    |    | Audit                  |   | Remuneration |   |
|                     | A                  | B  | A                      | B | A            | B |
| Edward Ellyard      | 12                 | 12 | 2                      | 2 | 1            | 1 |
| Kenneth Russell     | 12                 | 12 | *                      | * | *            | * |
| Dennis Wilkins      | 11                 | 12 | 1                      | 2 | 1            | 1 |
| Richard O'Shannassy | 12                 | 12 | 2                      | 2 | 1            | 1 |
| Terence Nilsen      | 1                  | 1  | *                      | * | *            | * |

**Notes**

A Number of meetings attended.

B Number of meetings held during the time the director held office during the year.

\* Not a member of the relevant committee.

## DIRECTORS' REPORT (CONT'D)

## SHARES UNDER OPTION

At the date of this report there are 5,550,000 unissued ordinary shares in respect of which options are outstanding.

|  | Number of options      |                   |
|--|------------------------|-------------------|
| Balance at the beginning of the year                                     | 44,225,002             |                   |
| <b>Movements of share options during the year</b>                        |                        |                   |
| Issued, exercisable at 20 cents, on or before 30 November 2010           | 750,000                |                   |
| Issued, exercisable at 50 cents, on or before 30 November 2010           | 5,000,000              |                   |
| Expired on 31 March 2009, exercisable at 35 cents (listed)               | (44,000,002)           |                   |
| Expired on 31 March 2009, exercisable at 35 cents (listed)               | (225,000)              |                   |
| <b>Total number of options outstanding as at 30 June 2009</b>            | <b>5,750,000</b>       |                   |
| Movements subsequent to year end:  |                        |                   |
| Cancelled, exercisable at 20 cents, on or before 30 November 2010        | (200,000)              |                   |
| <b>Total number of options outstanding as at the date of this report</b> | <b>5,550,000</b>       |                   |
| The balance is comprised of the following:                               |                        |                   |
| Expiry date  | Exercise price (cents) | Number of options |
| 30 November 2010   | 20                     | 550,000           |
| 30 November 2010   | 50                     | 5,000,000         |
| <b>Total number of options outstanding at the date of this report</b>    |                        | <b>5,550,000</b>  |

No person entitled to exercise any option referred to above has or had, by virtue of the option, a right to participate in any share issue of any other body corporate.

## INSURANCE OF DIRECTORS AND OFFICERS

During or since the financial year, the Company has paid premiums insuring all the directors of Key Petroleum Limited against costs incurred in defending proceedings for conduct involving:

- (a) a wilful breach of duty; or
- (b) a contravention of sections 182 or 183 of the Corporations Act 2001, as permitted by section 199B of the Corporations Act 2001.

The total amount of insurance contract premiums paid is \$31,080.

## NON AUDIT SERVICES

There were no non audit services provided by the entity's auditor, Bentleys, or associated entities.

## PROCEEDINGS ON BEHALF OF THE COMPANY


No person has applied to the Court under section 237 of the Corporations Act 2001 for leave to bring proceedings on behalf of the company, or to intervene in any proceedings to which the company is a party, for the purpose of taking responsibility on behalf of the company for all or any part of those proceedings.

No proceedings have been brought or intervened in on behalf of the company with leave of the Court under section 237 of the Corporations Act 2001.

## AUDITOR'S INDEPENDENCE DECLARATION

A copy of the auditor's independence declaration as required under section 307C of the Corporations Act 2001 is set out on page 25.

Signed in accordance with a resolution of the directors.



**Dennis Wilkins**  
Finance Director  
Perth, 30 September 2009